IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1941.

GEORGE COTROS et al.,
Petitioners,

vs.

NASHVILLE TRUST COMPANY, Executor Under Will of CHARLES McCABE, Former Collector Internal Revenue,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

APPLICABLE STATUTE.

"The term 'Corporation' includes associations, joint stock companies and insurance companies.

"The term 'Partnership' includes a syndicate, group, pool, joint venture or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this Act, a trust or estate or a corporation; and the term 'Partner' includes a member in such syndicate, group, pool, joint venture or organization."

U. S. Code Ann., Vol. 26, Sec. 1696.

QUESTION PRESENTED.

Are George Cotros and those who signed the Indenture of April, 1934, to be treated as an Association taxable as a Corporation under the above-quoted Statute?

The District Court answered this question in the negative, while the Court of Appeals answered in the affirmative, basing its decision solely upon the decision of this Court in *Helvering v. Combs,* 296 U. S. 365.

It is obvious, therefore, that if the instant case is governed by *Helvering v. Combs,* supra, the Petition for Certiorari should be denied.

If, on the other hand, the instant case is not parallel with *Helvering v. Combs,* but is to be determined under the principles announced in the case of *Lewis v. Commissioner,* 301 U. S. 385, and kindred Federal Appellate decisions, then the Writ should be granted.

GOVERNMENT'S CONTENTION.

It is the insistence of the Government that Paragraph 4 of the Indenture of April, 1934, created an express Trust in the nature of a business Trust; that this Trust was engaged in a business enterprise in developing and producing and in the marketing and sale of oil, such business activity being conducted by Cotros, Papageorge and Taras acting as Trustees for the benefit of all whose names were on the Indenture.

PETITIONERS' CONTENTIONS.

1. The parties to the Indenture of April, 1934, were tenants in common with each other, with respect to the fractional interest in the leasehold estate.

2. The character of the group, under the instrument of April, 1934, was that of a Joint Venture.

3. The purpose of the Indenture was not to finance the development of oil wells and engage in the business thereof—the wells were financed long prior to the creation of the so-called Trust, or the execution of the Indenture of April, 1934. The purpose was to hold and conserve the fractional leasehold interest for the benefit of the parties thereto; to receive and distribute the income therefrom.

4. The parties to the instrument of April, 1934, were not engaged, either through themselves or through the parties named as Trustees, in carrying on a business enterprise.

5. Even though it be said that some business activity was performed by the Trustees, Cotros, Papageorge and Taras, such was purely incidental to the mere collection of the income derived from the ownership of the fractional leasehold interest and the distribution thereof.

6. None of the attributes of a corporation or legal entity, such as an Association with corporate powers, existed.

CHARACTER OF INTEREST ACQUIRED UNDER INDENTURE.

In Revenue cases State Laws are controlling as to the **character** of interest acquired in property.

Crooks v. Harrelson, 282 U. S. 55;
Poe v. Seaborn, 282 U. S. 101;
Everts v. Commissioner, 38 B. T. A. 1039.

The Federal Appellate Court said this was immaterial, as the law itself (Statute above quoted) furnished its own criteria.

True, but the Statute defines a "Joint Venture" as a "Partnership," and not taxable as an "Association."

The property upon which the leasehold existed was in the State of Louisiana. The Supreme Court of Louisiana has held that an agreement between two or more persons

to engage in the buying of oil and gas leases on which to drill for oil for joint account and divide the profits is a "Joint Adventure."

Emerson v. Shirley, 188 La. 196.

The Federal Appellate Court for the Fifth District has held that one to whom is assigned an interest in an oil lease acquires an interest in real estate.

Hamilton v. Glassell, 57 Fed. (2) 1032.

PETITIONERS JOINT ADVENTURERS.

A "Joint Adventure" has been defined as "a special combination of two or more persons where in some specific venture a profit is jointly sought without actual partnership or corporate designation."

Bowmaster v. Carroll, 23 Fed. (2) 825;
Tompkins v. Commissioner, 97 Fed. (2) 396.

The Tompkins case, supra (a Revenue case), defines a "Joint Venture" as: "an Association of two or more persons to carry out a single business enterprise for profit."

Likewise, the Federal Appellate Courts, where the *res* is an interest in real estate, make little distinction between one owning an undivided interest in a leasehold as a Tenant in Common and a Joint Adventurer interested in profits to be derived from the leasehold.

Clark v. Sidway, 142 U. S. 682, Opin. 690.

The fact that a contract which constitutes a joint venture fails to provide specifically for sharing in the losses, but only refers to sharing in the profits, does not relieve the parties thereto of liability for losses, nor is it decisive of the issue as to whether or not the undertaking is a joint venture.

First Mechanics Bank v. Commissioner, 91 Fed. (2) 275.

The Government, according to its Brief filed in the Appellate Court, conceded that Cotros, Papageorge and Taras were, prior to the instrument of April, 1934, tenants in common with the Lincoln Oil Company.

Gov't's Brief, Appellate Ct., p. 9.

The Government's counsel, likewise, impliedly concedes that if the fractional interest of the parties to the Indenture was an interest in the leasehold, i. e., the real property itself, the Morrissey and Combs cases would not apply.

Gov't's Brief, Appellate Court, pp. 9, 14.

MORRISSEY AND COMBS CASES NOT APPLICABLE.

"It (Association) may be defined as a body of persons acting together without a charter, but using the methods and forms of corporate bodies in the perfection of some business enterprise for profit.

"It implies the entering into a joint enterprise * * * an enterprise for the transaction of business."

Morrissey v. Commissioner, 296 U. S. 344.

"The mere receipt of income from leased property and its distribution to cestuis que trustent amounts to no more than receiving the ordinary fruits that arise from the ownership of property and does not constitute *doing business* * * *. The power of the Trustees to receive rents and distribute them to certificate holders did not have the effect of making it an Association for profit; nor did the right to possess and dispose of the property * * * have that effect, but was a mere incidental power." (Italics ours.)

Cleveland Trust v. Commissioner, 115 Fed. (2) 481, Opin. 483-84;
Lewis v. Commissioner, 301 U. S. 385;
Commissioner v. Chase Nat'l Bank, Aug. 14, 1941.

Chief Justice Hughes, in the *Morrissey* case, stated that the paramount issue in determining whether a Trust was an Association within the meaning of the Revenue Laws lay in the fact that such Trust was engaged in the transaction of a business enterprise, "doing of business."

Said this Court with respect to an Excise tax imposed by the Revenue Act of 1909 upon corporations "engaged in business"—

> "The mere receipt of income from property and the payment of administration expense incidental to the receipt and distribution thereof (does not) constitute such a business ('doing business') as is taxable within the meaning of the Act."
>
> *McCoach v. Minehill R. R.*, 228 U. S. 298, Opin. 306-308.

Before analyzing or differentiating the Combs case from the instant case, we think the above quotations apt in disclosing the essential elements under which a syndicate, or joint group of persons, without charter, is to be treated as an Association taxable as a corporation under the Revenue Laws, and the distinguishing elements when it is not to be so taxed.

That is to say with respect to a Trust—

A. The carrying on of a business enterprise for profit after the method and manner of a corporation, legal title being vested in the Trustees, with transferable certificates of interest and limitation of liability, is an "Association" taxable as a corporation.

B. But the mere receipt by Trustees, named in a declaration of trust, of income from property leased or jointly held does not create, under the law, an Association taxable as a Corporation, even though the Trustees are given power incidental to the main purpose of the Trust, to lease, sell, manage, control or dispose of the property.

These conclusions are supported by

Lewis v. Commissioner, 301 U. S. 385;
Commissioner v. Chase Nat'l Bank (2nd Cir.), August 14, 1941;
McKeen v. Scofield, Collector, 108 Fed. (2) 764;
Myers v. Commissioner, 89 Fed. (2) 86;
Commissioner v. Whitcomb Coca Cola Syndicate, 95 Fed. (2) 596.

It will be noted that beyond question the original relation between Cotros, Papageorge and Taras and the Lincoln Oil Company was that of a tenancy in common, each owning a fractional leasehold undivided interest in the bed of a Bayou;

That for the interest acquired by Cotros, Papageorge and Taras they paid to the Lincoln Oil Company (who owned the entire leasehold interest) $20,000.00;

That the Lincoln Oil Company undertook to develop and drill for oil upon the leasehold interest, Cotros, Papageorge and Taras having nothing whatever to do therewith;

That, under the terms of the lease, operating expenses incurred after the discovery of oil were to be defrayed proportionately, and the Record shows that they were deducted by the Lincoln Oil Company, and the net proceeds remitted to Cotros, Papageorge and Taras (Record p. 33);

That in February, following the execution of the lease in August prior thereto, and either during the course of the drilling, or after oil had been struck, Cotros, Papageorge and Taras gave a power of attorney to the Lincoln Oil Company, authorizing it to handle and market and sell the oil produced and to remit to them their proportionate share of the net revenue with a statement of account (Exhibit 1, Cotros, and Record p. 32);

That subsequent to the execution and delivery of this

power of attorney the Indenture of April, 1934, was entered into (Record p. 26).

The sole contention of the Government is that Paragraph 4 of the Indenture changed the relationship of the parties from that of joint venturers, or tenants in common, to an Association taxable as a Corporation.

Gov't's Brief in Ct. Apps., p. 9.

Concededly, if this Indenture had not contained the so-called declaration of trust, the parties thereto would not have been taxed as an Association, but merely as a partnership or joint venturers. While clause 4 of the Indenture gave to Cotros, Papageorge and Taras the right to control the leasehold interest and to sell or dispose of same, all the while making a proper accounting to the other parties to the instrument, yet—

The legal title to the leasehold interest never vested in Cotros, Papageorge and Taras, as **Trustees**; they, as individuals, had the legal title under the lease from the Lincoln Oil Company, and could, at all times, as individuals, have sold or disposed of the lease. Whether we regard the other parties to the instrument of April, 1934, as equitable owners of a fractional interest in the leasehold, or as equitable owners of the income to be derived therefrom, the fact remains that other than calling Cotros, Papageorge and Taras "Trustees," their duties were no more, nor less, than to collect the income and properly account therefor by distributing the proceeds—in other words, the creation of the legal relationship of principal and agent.

In the language of this Court in the Lewis case:

> "There is to be found in the operation of the business (collection of rents and proceeds derived from the sale of land subdivided) no essential characteristic of corporate control—nothing analogous to a Board of Directors or shareholders, no exemption from personal

liability, no issue of transferable certificates of interest. There is simply the common relationship of principal and agent, coupled with the collateral incidents of an ordinary trust."

301 U. S., Opin. 389.

DISTINGUISHING CHARACTERISTICS OF INSTANT CASE FROM HELVERING v. COMBS.

1.

Combs Case.

We have obtained a certified copy of the Transcript of Record of the Helvering-Combs case, submitted to and decided by this Court at the October Term, 1935, and here desire to direct the Court's attention to the facts therein from which this Court held the Association there to be, in all respects, similar to a corporation, to wit:

1. Under the law of California, the Corporate Securities Act required that an express trust, organized for the purpose of selling securities evidenced by beneficial certificates or otherwise, should be filed with the Commissioner of Corporations and a permit obtained for such sale and a copy of the Trust Declaration filed.

Deering's General Laws of California, Section 3814, Vol. 2, p. 1924.

2. Having in mind the public issuance and sale of beneficial certificates, Everett and Combs, as Trustees, applied to the Commissioner of Corporations for a permit to that end, and filed with the Commissioner, a Declaration of Trust, the purpose of which was to finance and drill a well for the production and sale of oil. In the inception they were joined in the enterprise by the Hub Oil Company and Sheridan Bailes, an oil driller. Just as in a charter of incorporation, it was set out that the purpose of these par-

ties was to finance and drill a well for the production of oil, and to sell the production thereof, and to issue beneficial certificates to those who might become interested in the project.

3. Under the Trust instrument the Trustees as such were vested with legal title to the property—the entire leasehold having been assigned to them; they were to use the money dposited by the beneficiaries for materials incident to the drilling; to pay for the drilling; to manage and protect the Trust property; to pay the Trust debts; to sell and contract for the sale of the products of the well; to borrow money upon the credit of the Trust; to pledge the interest of the entire Trust property for the payment of debts; to issue and sell beneficial interest evidenced by certificates transferable only on the books of the Trust by surrender of the original certificates, etc.; to sell unsold beneficial interest for the benefit of the Trust. The Trustees were not to be individually liable. Each holder of a beneficial certificate was required to pay the sum subscribed to the Bank of Italy for the benefit of the Trust.

Transcript of Record, Helvering v. Combs, No. 238, October Term, 1935, pp. 36-43.

The Circuit Court of Appeals in the *Combs* case found the following:

1. It was **conceded** that the Trust was organized for the purpose of doing business and actually conducted a business enterprise.

2. That the Trust Agreement gave to the Trustees powers over the property of the Trust similar to those of a Board of Directors of a Corporation.

3. The beneficiaries—i. e., those who bought beneficial interest or certificates—had no participation in the selection of the Trustees or their successors.

4. The Trustees as such handled and controlled the marketing of the oil as well as the production thereof.

The issuance of beneficial certificates was subject to the approval of the Commissioner of Corporations.

Opin. Wilbur Circuit Judge, p. 5, Transcript of Record in this Court.

The facts found by the Circuit Court of Appeals were not questioned or contradicted in this Court, and, in addition thereto, this Court found:

That the beneficial certificates under the Trust Agreement were transferable only upon the books of the Trustees and endorsement and surrender of the certificates;

That the Trustees were authorized to hold all property, the legal title to which vested in them under the Trust, and to use the moneys deposited by the beneficiaries to pay for labor, casing and other materials incident to drilling and production; to pay Trust debts, sell products of the well, borrow money and sell unsold beneficial interest as they might deem best for Trust purposes.

Under these facts, this Court held that the parties joined in a common enterprise for the transaction of business; that the purchasers of beneficial interests were to be treated as *original parties* to the *enterprise* or joint undertaking prescribed by the Declaration of Trust, they being named (referred to) *therein as parties to the Trust,* designated as "Beneficiaries" (similar to shareholders in a corporation); and thus "they avoided the characteristic responsibilities of partnership and secured advantages analogous to those which pertain to corporate organization."

2.

Instant Case.

In the instant case there was no trust created for the purpose of financing and developing an oil well, or other property; no creation of a trust for the purpose of selling beneficial interests in the oil well to be developed; nothing done by Cotros, Papageorge and Taras, either prior or subsequent to the Indenture of April, 1934, analogous to a corporation or to the doing of business after the method and manner of a corporation.

So far as the "Trust" created under the Indenture of April, 1934, is concerned, it was confined to the management and control of the interest of the parties whose names were annexed thereto, and in the performance of such duties imposed upon the Trustees nothing was done, or contemplated to be done, other than the mere collection of income and the distribution thereof.

The property rights of the beneficiaries under the Indenture were those of a purchaser of a fractional part of a fractional part of a leasehold; there was no undertaking on their part to enter into a business enterprise; they were concerned only in receiving income from that which they bought, and the placing of their interest in the hands of Cotros, Papageorge and Taras was merely to have someone act for them in managing their investment.

There was nothing whatever in the Indenture Instrument, or in the creation of the so-called Trust, in Paragraph 4 thereof, which, by analogy, could be said to be engaging in a business enterprise to escape the responsibilities of a partner or Joint Venturer—nothing corresponding to an Association similar in characteristics, or otherwise, to a corporation.

The purpose of the Indenture was only to conserve and invest and receive the fruits therefrom. The powers of the Trustees were purely incidental to this purpose, and this is evidenced by the fact that the only functions performed by the Trustees consisted of the collection of the income and the distribution thereof.

We respectfully insist there is no analogy between the Combs case and the instant case; that the principles announced in Combs and Morrissey cases do not apply here, but rather is the present case controlled by

Lewis v. Commissioner, 301 U. S. 385, and
Commissioner v. Chase Nat'l Bank, Aug. 14, 1941.

Briefly referring to the recent Federal Decision of the Second Circuit, *supra*—

The Bank was the Trustee in a trust agreement made with the American Depositor Corporation, whereby certain fixed trusts, called "Corporate Shares," came into being. The purpose of the trust was to enable investors to acquire an interest in a list of securities, and they were given certificates showing their interest in the "Trust Shares." The Trustee had large powers to sell and reinvest the property rights acquired under the Trust Agreement. Certificate holders were expressly relieved of liability—persons dealing with the Trustee looking only to the Trust property. Trustee administered the trust in accordance with the agreement, and from time to time distributed the profits (income) to the holders of certificates. The Court of Appeals, Second Circuit, held this Trust was not to be treated as an Association taxable as a Corporation under Section 801 (a) of 1934 Revenue Act, saying:

> "The principles set forth in *Morrissey v. Commissioner*, 296 U. S. 44, leads to the conclusion * * * that the trust property was to be held for investment,

and not to be used as capital in the transaction of business for profit like a Corporation organized for such a purpose * * *. The Board of Tax Appeals found that there was no exercise by the Trustee, the depositor, or both combined, of any powers beyond those which are necessary incidents to the preservation of trust property, the collection of income therefrom, and its distribution to the holders of trust shares. That being so, these trusts do not fall within the statute upon which the Commissioner relies."

THE POWER OF ATTORNEY.

In an effort to maintain that the "Trust" was engaged in a business enterprise, the learned Counsel for the Government insists that inasmuch as *prior* to the execution of the Indenture, Cotros, Papageorge and Taras gave a power of attorney to the Lincoln Oil Company, authorizing it to market and sell the oil produced from the wells, they thus "engaged in business"—that the act of the agent is to be treated as the act of the Principal—and they claimed that as this Power of Attorney was not revoked after the execution of the Indenture, it inured to the benefit of all parties to that agreement, and hence the "business" of selling the oil is to be treated as the "business" of the syndicate.

Without undertaking to argue that this conclusion is a "*non sequitur,*" suffice it to say that the mere sale of oil derived from a well by the owners thereof is a necessary incident to the enjoyment of the fruits of the production—the only way by which the owners can obtain the benefit of that which the soil produced. They might as well argue that a group of farmers who sell their produce through a common agent is engaged in business, which makes them an association taxable as a corporation.

Whether Cotros, Papageorge and Taras sold the oil, or

did so through an agent, certainly such sale does not constitute "doing business." In no other way could the producer of the oil derive any benefit from his investment.

We respectfully ask that the Petition be granted and that the Writ issue.

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